

197273  
**LEBOEUF, LAMB, GREENE & MACRAE**  
L.L.P.

A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

NEW YORK  
WASHINGTON, D.C.  
ALBANY  
BOSTON  
DENVER  
HARRISBURG  
HARTFORD  
HOUSTON  
JACKSONVILLE  
LOS ANGELES  
NEWARK  
PITTSBURGH  
SALT LAKE CITY  
SAN FRANCISCO

1875 CONNECTICUT AVENUE, N.W.  
WASHINGTON, DC 20009-5728

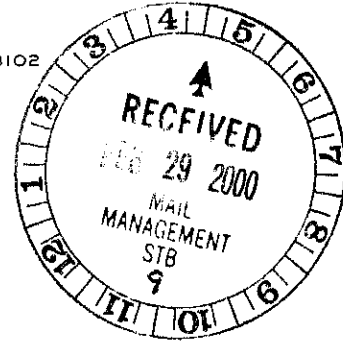
(202) 986-8000

TELEX: 440274 FACSIMILE: (202) 986-8102

WRITER'S DIRECT DIAL:

(202) 986-8050

February 29, 2000



LONDON  
(A LONDON-BASED  
MULTINATIONAL PARTNERSHIP)

PARIS

BRUSSELS

MOSCOW

RIYADH  
(AFFILIATED OFFICE)

TASHKENT

BISHKEK

ALMATY

BEIJING

**VIA HAND DELIVERY**

Mr. Vernon A. Williams  
Secretary, Surface Transportation Board  
Room 2215  
1201 Constitution Ave., N.W.  
Washington, D.C. 20423

RECEIVED  
Office of the Secretary  
FEB 29 2000  
U.S. DEPT. OF  
TRANSPORTATION

Re: Ex Parte No. 582, Public Views on Major Rail Consolidations

Dear Secretary Williams:

Enclosed are the original and ten copies of the "Statement of Enron Corporation" for filing in the above-referenced proceeding, and a diskette containing the Statement in WordPerfect format.

Also enclosed are three additional copies for date stamping and return via our messenger.

The oral presentation on Thursday, March 9 will be made by Daniel Reck, Vice President of Enron North America. He will be accompanied by the undersigned.

Very truly yours,

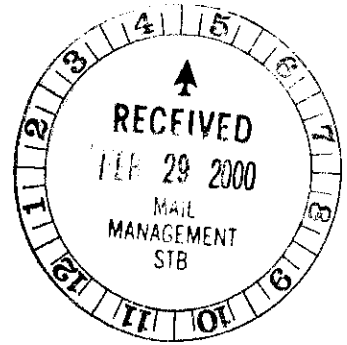
*Bruce W. Neely*

Bruce W. Neely

Attorney for Enron Corporation

Enclosures

UNITED STATES OF AMERICA  
DEPARTMENT OF TRANSPORTATION  
SURFACE TRANSPORTATION BOARD



---

EX PARTE NO. 582

---

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

---

FILED  
FEB 29 2000  
Office of the Clerk, STB

FEB 29 2000

File of  
Public Record

STATEMENT OF ENRON CORPORATION

Michael F. McBride  
Bruce W. Neely  
Margaret Hardy  
LeBoeuf, Lamb, Greene & MacRae, L.L.P.  
1875 Connecticut Ave., N.W., Suite 1200  
Washington, D.C. 20009-5728  
(202) 986-8000 (Telephone)  
(202) 986-8102 (Facsimile)

Attorneys for Enron Corporation

Due Date: February 29, 2000  
Dated: February 29, 2000

## **Introduction and Executive Summary**

In accordance with the Board's January 24, 2000 notice in this proceeding, Enron Corporation ("Enron") hereby submits its comments on "major rail consolidations and the present and future structure of the North American railroad industry." Enron applauds the Board for convening this proceeding because the railroad industry is at a crossroads. For 20 years, the railroads have followed a strategy of growing through acquisitions, improving efficiency, and increasing single-line service. Enron supports improved service and increased single-line service and is not opposed to mergers as such. But the railroads industry's traditional market strategy is no longer working for either customers or the railroads. The last few major mergers have limited competitive alternatives for customers, resulting in inefficiency, poor service, and drastically lower equity values for the railroads themselves.

It is now time for a new approach to the market if the railroad industry is to grow. Based on our own experience as one of the nation's largest natural gas pipeline companies and the leading marketer of coal, natural gas, and electricity, Enron believes this new approach will require the railroad industry to focus on their operations and develop a method to allow them to respond to the market and increase profitability. These goals cannot be accomplished through re-regulation, and Enron does not propose that the Board re-regulate the rail industry. Rather, the railroads need the ability to recognize and maximize the market value of rail "capacity". To unlock this value, railroads must offer customers increased competitive alternatives, flexibility in the way they can use the rail network, and transparent pricing information.

Enron believes a necessary element for achieving these ends is the creation of a system of tradable capacity rights, which will allow customers to build an infinite number of "virtual railroads". By permitting customers to trade capacity in a secondary market, the rail network will be better utilized and the market value of the railroads' capacity will be maximized. Trading

capacity rights will allow the railroads to optimize their operations, maximize the value of their assets, and increase their return on capital. By building virtual railroads through the trading of capacity rights, customers will gain increased flexibility even in the face of future consolidation. Enron therefore encourages the Board to establish a procedure for industry participants to develop a system of tradable capacity rights.

In support hereof, Enron states:

### **Description of Enron Corporation**

Enron was formed in 1985 through the merger of InterNorth, Inc. and Houston Pipeline Company. At that time, Enron's business was focused on natural gas and natural gas liquids. Enron's principal assets were interstate natural gas pipeline companies, which are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") under the Natural Gas Act, 15 U.S.C. § 717 et seq., and intrastate pipelines, which are subject to the jurisdiction of the States.

In that same year, the FERC began a process of opening natural gas markets to competition.<sup>1</sup> Enron initially resisted those efforts. Enron, however, came to embrace competition in order to grow in a fundamentally changed market. Today, Enron is the nation's second largest pipeline company, with pipelines that stretch from California to Florida, from Texas to the upper-Midwest, and from Canada to Chicago. With the opening of natural gas

---

<sup>1</sup> See Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. & Regs. [Reg. Preambles 1982-1985] ¶ 30,665 (1985) (subsequent history omitted). The FERC broadened the scope of its pro-competitive policies in 1992 in Order No. 636, Pipeline Service Obligation and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 30,939 (1992) (subsequent history omitted).

markets to competition, Enron was one of the leaders in the development of natural gas marketing and is now the nation's leading marketer of natural gas. Likewise, when the FERC opened the wholesale power market to competition,<sup>2</sup> Enron pioneered the development of power marketing and is now the nation's leading marketer of electricity. Enron also owns Portland General Electric Company,<sup>3</sup> which is subject to the jurisdiction of the FERC under the Federal Power Act, 16 U.S.C. § 824 et seq., and the State of Oregon, as well as numerous electric power plants that sell into the non-regulated electric market. Outside of the United States, Enron is engaged in developing assets in more than 30 countries in Latin America, Europe, Africa and Asia.

Enron also provides broadband services through the Enron Intelligent Network, which is a flexible global broadband network that allows for broadband and content delivery (that is, high quality video streaming and large file transfer). Enron actively supports the trading of bandwidth to best allocate resources. Since late 1999, Enron has provided an internet-based energy market transaction system through Enron Online. This system has already conducted over 10,000 transactions representing more than \$10 billion in business.

Enron's transformation and growth from its origins as a company formerly operating in

---

<sup>2</sup> See Order No. 888, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities, FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 31,036 (1996), Order No. 888-A, on reh'g, III FERC Stats. & Regs. [Regs. Preambles] ¶ 31,048 (1997), Order No. 888-B, on reh'g, 82 FERC ¶ 61,046 (1998), pet. for review pending sub nom., Transmission Access Policy Study Group et al. v. FERC, No. 97-1715, et al. (D.C. Cir. Apr. 30, 1998).

<sup>3</sup> Enron has agreed to sell Portland Electric General Company to Sierra Pacific Power Company. The sale is subject to approval by various regulatory authorities, which has not yet been obtained.

the largely regulated natural gas business, to today has been dramatic. In 1990, Enron's market capitalization was \$3.2 billion and has since grown to over \$46 billion.<sup>4</sup>

### **Position of Enron Corporation**

Enron's interest in this proceeding stems from its coal trading activity. Since 1997, Enron has been actively engaged in trading coal, both in the United States and internationally. Enron delivered 24 million tons of coal to its customers in 1999 and will deliver over 30 million tons in 2000. The vast majority of this coal is shipped by Enron's customers on railroads in the United States. A financially sound and market responsive rail system will be important to the growth of Enron's coal trading business. Based on the extensive experience it has gained from operating in the deregulated natural gas and electricity markets, as well as its operation of an extensive transportation network in a competitive market, Enron believes that the railroads can maximize profits by responding to market signals -- indeed, that market responsiveness is the key to the future profitability of the railroads.

#### **A. The Problem With the Current Structure of the Railroad Industry**

In Enron's view, the primary problem facing the railroad industry and the Board in shaping policy for the future is this: The railroads are not market responsive and therefore are not maximizing the value of their assets. The current rail system is inflexible. It neither allocates capacity in response to short-term market signals nor efficiently meets long-term demands. The simple fact is that the market mechanisms needed to enable the railroads to be market responsive do not exist. Given the current equity valuations of the railroads, the need to develop these mechanisms is critical.

---

<sup>4</sup> Based on Enron's closing price as of February 28, 2000.

A comparison with the interstate pipeline industry is instructive. Interstate pipeline companies receive real-time price signals from the market because the FERC created a secondary market for pipeline capacity.<sup>5</sup> In this secondary market, a pipeline customer with a firm transportation contract can offer to sell, or release, the capacity under contract, or some portion of it, to a third party. A company wanting that capacity, or some portion of it, can bid for the capacity. Thus, when a customer does not need capacity the customer can sell the excess capacity; and a pipeline customer temporarily needing additional capacity can acquire it. Moreover, the customer acquiring the capacity can also add it to capacity purchased from the pipeline, another pipeline customer, or even another pipeline -- thus enabling the customer to create a virtual pipeline, as the FERC has recently noted:

has made possible the development of virtual pipelines. A virtual pipeline can be created when a marketer or other shipper acquires capacity on interconnecting pipelines and can schedule across the interconnect, creating in effect a new pipeline between receipt and delivery points that are not physically connected under a single pipeline management.<sup>6</sup>

As a result of the customers trading capacity in the secondary market and the creation of virtual pipelines, the pipeline learns the value its capacity has in the market. That information allows the operator to appropriately allocate capital and resources.

---

<sup>5</sup> Regulations governing this secondary market are codified in 18 C.F.R. § 284.243 (1999). The FERC has recently revised these regulations in a way that is not material here. Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services, 90 FERC ¶ 61,109 (2000). The revised regulations will be codified in 18 C.F.R. § 284.8. Customers can also effectively trade capacity by buying and selling "delivered gas."

<sup>6</sup> Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services, *supra*, slip op. at 18.

But railroads generally do not provide a mechanism for a customer to trade its rail capacity to another customer. For the most part, the customer's contract is not even assignable. As a consequence, there is no way for the customer to determine the value of its capacity or to sell excess capacity. By the same token, a customer needing additional service cannot obtain it without contracting directly with the railroads, generally under long-term contracts.

More importantly, the railroads themselves do not even know the value of their capacity in the market. This prevents the railroads from capturing the value of their assets and efficiently allocating capital. This has to change if the railroads are to continue to grow and profit.

#### **B. A New Business Model for the Railroad Industry**

In the 1980s, natural gas pipelines faced some tough years, and one interstate pipeline went into bankruptcy. But the industry survived and is now thriving, including the once-bankrupt pipeline. The railroads can learn from the pipelines' experience -- and, indeed, grow as the pipelines have grown.

One of the building blocks on which the pipelines' revival rests is the system of tradable capacity rights described above. In essence, this system is a market-driven mechanism for putting the rights to use the pipeline system into the hands of the customers that value the capacity most. It is beneficial for customers and the pipelines alike because it provides the private sector:

- a method for resolving capacity constraints, especially short-term constraints, thus enhancing reliability;
- a means for each customer to maximize the value of its contract with the pipeline by using the system or trading its rights to someone that wants to use the system, thereby increasing the utilization of the pipeline system;



- a competitive alternative for customers to purchase capacity directly from the pipeline;
- the ability for customers to access new markets; and
- a mechanism to determine the value of the pipeline's capacity, which is important information as to whether the pipeline needs to expand the system or some portion of it.

But perhaps the more important overall benefit provided by this system of tradable capacity rights is that the pipeline system is simply more flexible and responsive to the customers' changing needs and therefore more profitable to the owners. Railroads are different from pipelines. One obvious difference is in the way rates are set. Pipeline rates are generally set by the regulatory agency at cost, and these rates generally serve as a cap on prices in the secondary capacity market. Rail rates are generally not determined by the Board, and Enron does not propose to change that.

Developing a similar system of tradable capacity rights will unlock the value of the railroads' capacity; provide customers with the flexibility to maximize their usage of the rail system; improve the reliability of the rail network and enable the railroads to maximize the value of their capacity. Enron therefore urges the Board to make this need central in revising its merger policy.

Under a system of tradable rail capacity rights:

- Customers would have defined capacity rights between one or more points where the freight is received and delivered. In effect, the railroads would sell its capacity between these points to the customers for a defined period of time.
- Customers would have the option of buying capacity on the basis of tiered service levels, with rates reflecting the quality of service.
- Customers could trade their firm rights to the capacity to others. The customer acquiring the rights would be able to have its freight received and delivered anywhere between the points defined by the original customer. The customer acquiring another customer's rights may

combine the acquired rights with rights it has under contract itself or acquired from other customers. In this way, the acquiring customer can create its own "virtual railroad."

- Railroads could effectively increase the capacity of their existing infrastructure without additional capital expenditures.

A system of tradable rail capacity rights is clearly feasible because Burlington Northern and Union Pacific have a system by which grain shippers can trade rail capacity. Moreover, as an operator of natural gas pipelines, Enron knows that a necessary condition for pipelines providing the flexibility inherent in a system of tradable capacity rights has been the ability to maintain control over the operation of the pipeline. Railroads undoubtedly will need similar controls.

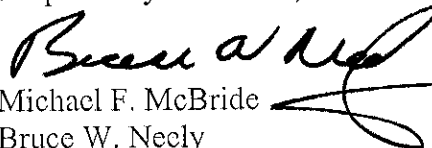
These issues need to be explored further. Enron therefore recommends that the Board establish a working group of industry participants to identify issues raised by the implementation of a system of tradable capacity rights and to develop a concrete proposal. This working group would operate under the oversight of the Board and would report back to the Board within 90 days. Enron would be delighted to participate in such a process.

## Conclusion

The railroads are at a crossroads. There are two choices: continue the present structure or change it. Continuing the structure is easy, and the Board will no doubt be urged to let the industry continue as it has. But consider the consequences of continuing the current approach. Under this approach, the railroads' return on capital is poor -- and will likely stay depressed; share prices of most Class I railroads have plummeted, thus limiting their ability to raise capital; and customers are dissatisfied. Change is inevitable and necessary.

Enron and the pipeline industry faced a similar challenges in the 1980s. Enron has embraced the changes that confronted the natural gas industry and, as a result, has grown dramatically. Enron therefore urges the Board to embrace change and to revise its merger policy in accordance with these Comments.

Respectfully submitted,



Michael F. McBride  
Bruce W. Neely  
Margaret Hardy  
LeBocuf, Lamb, Greene & MacRae,  
L.L.P.

1875 Connecticut Ave., N.W., Suite 1200  
Washington, D.C. 20009-5728  
(202) 986-8000 (Telephone)  
(202) 986-8102 (Facsimile)

Attorneys for Enron Corporation

Due Date: February 29, 2000  
Dated: February 29, 2000